Focusing on Competitors in Strategic Performance Management

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This article will be of interest to students of Professional 2 Strategic Performance Management and Professional 2 Strategy and Leadership.

Competitors and strategic performance management

A firm's strategy is likely to succeed only if it includes a strategy for "managing" its competitors. For example if our competitors reduce their cost base or engage in significant innovation, this creates potential for them to increase market share at our expense. Equally, if our own strategy is aggressive rather than defensive, we may wish to engage in these kinds of behaviours ourselves so as to expand our own market share. In either case, it is important that our strategy should include have a proactive (and not merely reactive) approach to managing the threats which our competitors pose to our ambitions.

Because of the importance of strategically managing competitors in this way, Area 4 of the P2 Strategic Performance Management (P2SPM) syllabus makes specific mention of "alternative competitive strategies" and "monitoring of the external environment (including competitor accounting)". Of course, information about competitors is necessarily external to the firm (in contrast to most traditional management accounting information). Therefore, although P2SPM builds on earlier subjects such as Management Accounting and Managerial Finance, one thing which is fundamentally different about P2SPM is this extension into collection and use of external information (much of it qualitative in character).

Who are our competitors?

Our competitors are all of those firms which compete for our customers' spending power. Kotler & Armstrong (2009) suggest that there are four types of competitors:

1. Brand competitors: These are the most obvious competitors. They are other firms which are similar in size to ourselves and who offer similar products to similar customers. An example of brand competitors is that Dunnes Stores is a competitor of Tesco.

2. Industry competitors offer similar products or services to ourselves but differ in some important way such as organisation size or the precise type of product offering or target market. Radisson Hotels and Ashford Castle Hotel are industry competitors.

3. Form competitors offer products or services which fulfil the same customer needs as ourselves even though the products or services are very different in form or technology. For example theatres, cinemas, DVD distributors, and bookstores are form competitors of each other.

4. Generic competitors: All consumers have limited incomes. Therefore, every firm is a potential competitor, at least for expenditures of similar magnitude. For example, a for-profit private school must recognise that generic competition for its services comes from the alternative items (such as luxury holidays) on which an affluent family might choose to spend its money

Which competitors pose the biggest threat?

From the above taxonomy, it appears that almost any other firm is an actual or potential competitor. We cannot (in practice) continuously monitor every other firm in existence, so some rule-of-thumb is needed to identify the most significant competitors. It has been suggested that the biggest competitive threat is likely to come from those who have some or all of the following characteristics:

1. They sell to the same type of customers as ourselves;
2. They have similar or lower-cost supply and distribution channels;
3. They have similar or superior technologies;
4. Their target market (in geographical or other terms) significantly overlaps with our own.

To illustrate this point, consider the arrival in Ireland a decade or so ago of hard discounter grocery chains such as Lidl and Aldi. Although these companies are clearly industry competitors of the other major supermarket chains operating in Ireland (such as Dunnes Stores and Tesco), nevertheless the newcomers might at first glance have seemed to pose little direct competitive threat to Dunnes, Tesco, etc., because of the newcomers' emphasis on low-price offerings of limited product ranges. However, it soon became apparent that (because their supply chains are extremely well managed and their stores have low operating costs per €1 of produce sold), the newcomers were able to appeal to consumers in almost every income bracket on the basis of product quality and service (and not merely on the basis of selling price alone). Consequently, the existing supermarket chains soon recognised that the newcomers were very real and direct competitors and reacted accordingly (e.g., by expanding their ranges of own-label products to include "value", "standard" and "premium" own brands).

What we need to know about our competitors

Having identified our competitors, the next step is to determine what it is we need to know about them in order to facilitate our strategic success. Hoque (2006) suggests that we should try to stay continuously informed about the following matters as regards each of our significant competitors:

1. What are the competitor's existing strategies and objectives? For example, do they aspire to increase market share at our expense and what is their strategy for doing so?

2. What are the competitor's major strengths and weaknesses? For example, if a competitor has high operating leverage then profits will change much more than proportionately if the volume of sales changes. Thus, high operating leverage is a strength in times of expansion but a major weakness when contraction occurs (e.g., in a time of economic recession).

3. How well is the competitor doing at present?

4. Can we predict the competitor's future moves? For example, we may discover that a competitor has been generating high profits, has a track record of low dividend payouts, and has a strategy of investing heavily in research and development to facilitate product innovation. In this case, it is likely that the competitor may seek to expand market share (at our expense) by offering better and quite possibly cheaper products.

In general, therefore, competitor analysis involves collecting information about competitors and using that information to predict (i) how the competitor is likely to react to our strategic decisions and (ii) what the competitor's future strategies will be and how we might react to him so as to minimise any adverse effects on ourselves.

Collecting information about competitors

Now that we know (in broad terms) what it is that we want to know about our competitors and why, the next step is to identify the specific types of information which we should try to collect. Fleisher and Bensoussan (2002) provide an exhaustive list of the information which should be gathered. This list is reproduced in Table 1. Three things should be said about this information:

1. Not all sources of information are likely to be gathered in every situation. Cost-benefit considerations, and an inability to access certain information sources, may prevent the collection of some information in some cases.

2. Notwithstanding the practical problems mentioned in the previous paragraph, most of the information suggested by Fleisher and Bensoussan can (in practice) be collected. For example, such marketing information as (i) key customers, (ii) segmentation strategy, and (iii) customer service emphasis are usually either publicly known or easily inferred. To illustrate this point, think of any business (such as a supermarket, airline, or bookstore) which you regularly patronise and try to write down marketing information under the categories listed in Table 1. You will probably find this quite easy even without conducting any thorough research.

3. Most of the information is qualitative in character.

<u>Competitor accounting</u>

The terms "competitor accounting" and "competitor analysis" are sometimes used synonymously (e.g., by Hoque, 2006). Alternatively, Ward (1992) suggests that the term competitor accounting should be used to refer to that part of competitor analysis which is concerned with two specific issues:

1. The financial evaluation of the barriers to entry facing potential new entrants (to an industry in which we already operate);

2. The estimation of competitors' costs.

These two issues are considered next.

<u>Barriers to entry</u>

Suppose you are a manufacturer of high-technology medical devices on which you have obtained the necessary patent protection. Any potential competitor who is contemplating entering this market clearly faces considerable financial barriers to entry, such as:

1. Capital equipment costs;

2. Research and development costs, to develop new products which are at least as good as your products yet do not breach your patent protection;

3. Operating cost advantages enjoyed by the existing manufacturer (such as economies of scale and learning curve effects);

4. Likely defensive reaction by the existing manufacturer (who may cut prices in order to defend his market).

Of course, a potential new entrant with patience (and deep pockets) can overcome these barriers. Patents expire, product lifecycles end, and learning curve advantages are temporary in nature.

A potential new entrant should conduct a cost-benefit analysis to determine if the long-run benefits of breaking into an established market justify the costs involved. Similarly, an existing firm is faced with the decision as to whether (in cost-benefit terms), the cost of taking actions to discourage a new entrant is worthwhile. Typical actions to discourage new entrants include increasing advertising expenditure (to increase existing customers' brand loyalty) and reducing selling prices (so that it would be difficult for a new entrant to operate profitably).

Estimation of competitors' costs

Knowledge of competitors' cost levels is useful for a number of aspects of our strategic decision-making. For example, suppose we know that our main competitor has cost levels which are significantly higher than ours and that he is barely breaking even at present. A number of inferences may be drawn which are useful for our strategic pricing decisions:

1. The competitor is most unlikely to instigate a price-cutting strategy, since he is barely breaking even at existing prices.

2. If we reduce our prices, it will be difficult for the competitor to follow suit, since to do so would bring him into loss-making territory.

3. The competitor is likely to exit the industry if price levels fall in the long term throughout the industry.

There is no doubt that knowledge of competitors' costs would be useful, but can that knowledge be obtained? Using a number of case studies, Brethauer (2000) shows that such information can be obtained, and at much lower cost (and in much greater accuracy) than is sometimes suggested. The following are examples of data sources from which a profile of competitor costs can be built up:

1. Tear-down analysis of products (to infer raw material and other input costs);

2. Statutory and industry guidelines on wage rates for the relevant labour skill grades;

3. The competitor's published financial statements;

4. Consultants and former employees of the competitor (subject to confidentiality limitations);

5. Physical observation of facilities used – for example, the amount and location of manufacturing and office space used is easily observable, and the cost can be estimated by reference to current market rental rates.

Conclusion

The strategic management of competitors takes the management accountant out of the traditional comfort zone in two ways, by requiring the collection and analysis of information which is both external to the firm and (for the most part) qualitative in nature.

Table 1: Information to be collected about competitors

(A) Marketing information:

1. Segmentation strategies;
2. Branding and image;
3. Advertising and promotions;
4. Customer service emphasis;
5. Likely growth vectors;
6. Market research capability.

(B) Information about products and services*.

(C) Information about strategy*.

(D) Human resources information*.

(E) Operations information*.

(F) Technological information*.

(G) Managerial profiles*.

(H) Socio-political information*.

(I) Information about organisation structure*.

(J) Competitive intelligence capability*.

(K) Customer value analysis*.

(L) Financial information*.

*These categories are based on Fleisher & Bensoussan (2002). The detailed subcategories under each of the categories (B) to (L) above can be seen in the original paper.

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